

Internal Revenue Service

memorandum

CC:TL-N-9306-90

Br2:JMSchwartzman

date: OCT 19 1990

to Nancy B. Herbert, International Special Trial Attorney CC:C

from Assistant Chief Counsel (Tax Litigation Division) CC:TL

subject

This is in response to your August 8, 1990 supplemental request for assistance concerning the Special Life Insurance Company Deduction (SLICD) issue in this case.

Computing the SLICD is relatively simple. All members of a controlled group<sup>1</sup> pool their tentative Life Insurance Company Taxable Incomes (LICTI) for the taxable year.<sup>2</sup> I.R.C. § 806(d)(1)(A). The controlled group's combined tentative LICTI for the year is then multiplied by twenty percent.<sup>3</sup> The product of that computation is the SLICD. Section 806(a). The Service and the taxpayer agree on this computation in the instant case.

The allocation of the SLICD, however, is more problematic. Fortunately, the government's position in this respect is one of stakeholder. That is, if the SLICD is \$100, controlled group member A can receive \$20 of the deduction and controlled group member B can receive \$80 or A and B can receive \$50 of the deduction each. The government still allows only \$100 of total deduction.

As a stakeholder, one of our primary concerns is to protect against a whipsaw. For example, here, if [REDACTED] received \$20 of

<sup>1</sup> As defined in section 1563. All sections refer to the 1954 Code, as amended and in effect for [REDACTED].

<sup>2</sup> LICTI means life insurance gross income minus life insurance deductions. Section 801(b). Tentative LICTI is LICTI before deduction of the SLICD and the small life insurance company deduction. Section 806(c)(1).

<sup>3</sup> The small life insurance company deduction, if any, is deducted from the controlled group's tentative LICTI before multiplying by twenty percent.

the SLICD, [REDACTED] should receive no more than \$80 of the SLICD.<sup>4</sup>

There are three possible methods for allocating the SLICD among the members of the controlled group with positive tentative LICTI. The examining agent's method proposed to determine [REDACTED]'s tentative LICTI by netting its capital gains for [REDACTED] against the capital gains and (mostly) capital losses of all members of the controlled group. Then, the SLICD is allocated among the controlled group members with positive tentative LICTI. We reject this method because it is unsupported by the statutory language and the legislative history.

The legislative history specifically provides that the, "special life insurance company deduction is then allocated proportionately among the life insurance company members of such group with a positive tentative LICTI." Tentative LICTI is LICTI before taking into account the special deductions. LICTI is insurance gross income minus life insurance deductions. There is no mention of netting capital gains against capital losses of controlled group members to compute tentative LICTI in a controlled group setting either in the statute or the legislative history.

The taxpayer's method proposed to allocate the SLICD according to each member of the controlled group's separately computed positive tentative LICTI. According to this method, the SLICD is not allocated to a consolidated return group on the basis of consolidated tentative LICTI, but to each member separately. Taxpayer's method is not unreasonable and can be supported by the language defining tentative LICTI in section 806(c) and the legislative history.

The most reasonable method and the method most compatible with the plain language of the Code and the legislative history, in our opinion, allocates the SLICD according to separate tentative LICTI, taking into account the consolidated return principles for consolidated return group members. In computing separate tentative LICTI of consolidated return group members, consolidated items are netted and the consolidated net figure is allocated back to the consolidated group members in proportion to each member's contribution to the item. For example, capital gains and losses of consolidated group members are netted to yield a net capital figure for the consolidated group. Treas. Reg. §§ 1.1502-11(a)(3) and 1.1502-22. If there is a net capital gain, it is allocated back to the group members with capital gain. See Treas. Reg. § 1.1502-79. Then, the SLICD is allocated

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<sup>4</sup> We understand that [REDACTED]'s [REDACTED] tax year was subject to a settlement agreement and, consequently, determining the amount of SLICD it received may be impossible.

among controlled group members with positive tentative LICTI. We accept this approach because it is reasonable to adopt the normal consolidated return principles for consolidated life-life groups.

Although we find this method more compelling, the taxpayer's method is not unreasonable. In addition, there is some litigation hazard involved because of the precedent set by Gottesman & Company, Inc. v. Commissioner, 77 T.C. 1149 (1981). In Gottesman, the petitioner, the parent of a consolidated return group, computed its accumulated taxable income on a separate basis. The Tax Court upheld petitioner's separate computation because its interpretation of ambiguous regulations was reasonable and the ambiguity was due to the Service's failure to prescribe more specific regulations. Here, we have failed to promulgate life-life consolidated return regulations and the taxpayer's method is reasonable, therefore, possibly subjecting us to the Gottesman standard.

In respect of the netting capital gains against capital loss carryovers issue, the taxpayer appears to have conceded. The position set forth in the August 2, 1990 Tax Litigation Advice to you on this issue is well supported. Specifically, consolidated net capital gain for a taxable year includes the "consolidated net capital loss carryovers or carrybacks to such year." Treas. Reg. § 1.1502-22(a)(1)(iii). Carryovers and carrybacks are determined in accordance with the principles of section 1212(a). Treas. Reg. § 1.1502-22(b).

In summary, we agree with the following conclusions, as expressed in the August 2, 1990 Tax Litigation Advice issued by Branch 3 of the Tax Litigation Division:

- 1) the SLICD is allocated on a consolidated return group basis; and
- 2) carryovers and carrybacks are used to offset capital gains in computing consolidated capital gain net income.

We understand that the amount in contention on the above issues at this point is nominal. Nonetheless, you informed us that settlement may not be possible in this case.

If you need any further assistance, please contact Jerry Schwartzman of this office at 566-3407.

MARLENE GROSS

By:



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